Crypto market in turmoil as rescue plan for bankrupt FTX falls through overnight

Nick Beams
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The collapse of the crypto currency company FTX and the withdrawal of a rescue operation by its major rival Binance, barely 24 hours after it was announced, has sent a shock wave through the crypto currency world, and pointed to sources of instability in the financial system more broadly.

On Tuesday it was announced that FTX, one of the largest crypto exchanges owned by the high-flying crypto entrepreneur Sam Bankman-Fried, reputed to have a fortune, at least on paper, of more than $20 billion, had been rescued from a liquidity crisis by its major rival Binance.

Binance chief Changpeng Zhao tweeted that FTX had "asked for our help" and said a letter of intent had been signed to "fully acquire" FTX and "help cover the liquidity crunch" with the "discretion to pull out from the deal at any time."

By late yesterday afternoon Zhao had exercised that option and the rescue operation was off.

Binance said its "hope" had been to support FTX's customers and provide liquidity "but the issues are beyond our control or ability to help."

Its statement said that "as a result of corporate due diligence, as well as the latest news reports regarding mishandled customer funds and alleged US agency investigations," Binance had decided not to pursue the purchase.

It has been reported that the Securities and Exchange Commission is expanding an investigation into FTX, probing its crypto currency lending products and its management of customer funds. The Commodities Exchange Commission is also investigating the company.

Besides the investigations, the state of FTX's finances was a key motivation for the Binance reversal.

According to a report on Bloomberg, it became clear within a matter of hours that rescuing FTX would be a "tall order" for Binance.

"Its executives found themselves staring into a financial black hole—a gap between liabilities and assets at FTX that's probably in the billions, and possibly more than $6 billion," it said, citing "a person familiar with the matter."

The initial intervention by Zhao did not arise from the "goodness of his heart" to protect FTX customers. It reflected fears that if FTX, valued at $32 billion at the start of this year, went under, it could set off a panic through the crypto trading system as a whole and impact severely on his own company.

That unraveling may now take place as the value of crypto currencies falls. Bitcoin, the most traded crypto currency, dropped 12 percent to $16,282, its lowest level since late 2020.

Jon de Wet, chief investment officer at the crypto wealth management firm Zerocap, told the *Financial Times* that "markets have now hit full panic" and "all hell is breaking loose."

The episode reveals how rapidly talk of financial problems can turn into a full-blown crisis within a matter of days or even hours.

Problems for FTX began to emerge last week when Coindesk, a news web site covering the digital market, revealed that Alameda Research, a hedge fund owned by Bankman-Fried, held a large portion of its assets in FTT, a relatively illiquid token owned by FTX.

It reported that as of June 30, Alameda's assets amounted to $14.6 billion of which $3.66 billion was in FTT. This prompted claims by at least one blogger that there was a parallel between Alameda and the Celsius Network crypto lender, which collapsed earlier this year amid accusations that it had been artificially enhancing its balance sheet by manipulating the value

of its own token, CEL.

Then on Sunday, the "drama reached fever pitch," in the words of a Bloomberg report, when Zhao said he would sell all his FTT holdings, worth an estimated $529 million, due to "recent revelations that came to light." The value of FTT then dropped by more than 70 percent.

This prompted a rush for the exits by large and smaller investors. According to a report in the *Wall Street Journal* (WSJ), FTX experienced a $1.4 billion withdrawal on the blockchain of the crypto currency Ethereum in 24 hours, as firms that facilitate crypto trades moved to other exchanges. Some smaller traders said they were not able to withdraw their funds.

FTX was not a small firm operating on the edge of the market but enjoyed the backing of key sections of finance capital. It was launched in 2019 and received money from Singapore's sovereign wealth fund as well as from the venture capital firm Sequoia Capital and the Ontario Teachers Pension Plan.

As the crypto market fell this year, after reaching a peak last November, FTX was held up as a highly valuable start-up company. According to the WSJ, its rise was fuelled by a "wave of nearly $2 billion in venture capital that rushed into the company over the past three years from a who's who of startup investing including SoftBank Group and Sequoia Capital." The hedge fund BlackRock also supplied capital.

It secured a naming rights deal with the stadium in which the basketball team Miami Heat plays, now called FTX Arena. Legendary NFL quarterback Tom Brady appeared in an ad for the company last year.

FTX was regarded as a well-managed company. Bankman-Fried was in regular discussions with lawmakers in Washington and appeared at conferences where he interviewed so-called "luminaries," including former President Bill Clinton and former UK Prime Minister Tony Blair.

But behind the wall of money and media promotion, there was a fundamental problem to which Cory Epstein, chief executive of Swan.com, a bitcoin financial services firm, drew attention in remarks to the WSJ.

Crypto firms, he said, because of their holdings of extremely volatile assets that have in many cases undergone large falls, "are inherently fragile, susceptible to a Lehman-like collapse at any time. And the only hope once under pressure is that another player will bail them out."

But as revealed in this case, there is always the prospect that such a bailout will not take place and the crisis of one firm will go far beyond the crypto system and impact on the financial system, involving major hedge funds and even pension funds.

In an earlier report, Bloomberg commented that for the crypto industry as a whole "FTX's demise is another example of a once-towering player laid low when a crisis of confidence forced a run on its assets. Like others before it, including lenders Celsius Networks and hedge fund Three Arrows Capital, reserves proved inadequate when market sentiment turned against it, even as top executives said nothing was amiss."

This description of the crypto world applies more broadly.

As recent reports by the International Monetary Fund and the Federal Reserve, among others, have made clear, there are major areas of the financial system where short-term funds have been placed in assets that cannot be quickly turned into cash if investors decide en masse to withdraw their money, prompting a situation akin to bank runs in the past but today involving far greater amounts of money.

These inherent contradictions have remained somewhat beneath the surface over the past 14 years, concealed by the massive injection of money into the financial system by the world's central banks as they have bailed out the corporations and the financial markets.

But they now threaten to burst to the surface in many areas, virtually overnight, as in the case of FTX, as the Fed and other central banks tighten monetary policy and lift interest rates to batter down the wage demands of the working class in response to rampant inflation.